STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

MidAmerican Energy Company	)	
	)	Docket No. 01-0696
Proposed general increase in gas rates	)	01-0696
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Rebuttal Testimony of Brian Ross

On behalf of the Citizens Utility Board

CUB Exhibit 2.0

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Q. Please state your name and business address.

A. My name is Brian Ross. My business address is 2634 Vincent Avenue North, Minneapolis, MN.

Q. Are you the same Brian Ross who has previously filed direct testimony in this docket?

A. Yes, I am.

Q. What is the purpose of your rebuttal testimony?

A. To respond to the rebuttal testimonies of Company witnesses Charles Rea, Gregory Schaeffer, and Rick Tunning. I will also respond to the direct testimony of Staff witness Michael Luth. My lack of response to any element or argument in any witness' direct or rebuttal should not be construed as my acceptance or agreement of said elements or arguments.

Rate Design

Q. On page 4 of his rebuttal testimony, Mr. Rea defines what he believes to be "the real issue that the Commission must decide" in regard to the appropriate Rate 60 customer charge. Do you agree with Mr. Rea's characterization (lines 64-69) of what the Commission must decide in evaluating the Company's rate design recommendations and yours?

A. No. Mr. Rea's characterization of the primary difference between his recommendations and mine is unfounded. He distinguishes his recommendations from mine on the basis of a

principle that he believes should guide rate design decisions; treating "overheads related to (a specific) service on the same basis as the direct (costs) for that service." Mr. Rea believes that I have violated this principle that overhead costs assigned in the COSS to customer-related accounts should be recovered through the volumetric charge rather than the customer charge. Yet both the Company and I propose to recover direct costs and overhead costs through the customer charge. Mr. Rea includes a large share of overhead costs in his ~~$12.89~~12.32 calculation of customer costs, upon which the Company based its recommended $12 Rate 60 customer charge. I removed most overhead costs from Mr. Rea's Cost of Service Study (COSS) results, showing a largely non-overhead customer cost of $8.53, upon which I recommended a customer charge of $9. The relationship of the Company' proposed rate design to the COSS is certainly different from mine in a matter of degree, but not in regard to the principle espoused by Mr. Rea.

Q. How does MEC apply Mr. Rea's allocation principle - that rates should charge "overheads related to (a specific) service on the same basis as the direct (costs) for that service"?

A. MEC recommends fairly strict adherence to the presentation of costs in its COSS for the design of its Rate 60. As noted above, MEC's COSS estimates a customer charge of ~~$12.89~~12.32, and MEC recommends a $12 customer charge. The Company, however, largely ignores Mr. Rea's principle in its proposed Rate 70 rate design. Of the total ~~$39.86~~41.08 customer cost identified in Mr. Rea's COSS, which includes both customer-related and common or overhead costs that are not customer-related, MEC proposes to recover the majority (6~~3~~2%) through volumetric charges (Schaeffer Rebuttal, page 7). The Company's proposed Rate 70 first

block volumetric charge includes a large share of overhead costs that Mr. Rea's COSS functionalized to customer-related accounts. MEC recovers much of the overhead cost in the first 1,000 therms of usage, meaning that most small users (defined in Mr. Schaeffer's rebuttal on page 7 as using less than 300 therms, and comprising 75% of Rate 70 customer bills) escape paying for a substantial portion of these overhead costs. The remaining overhead costs are recovered in the second block, from 1,000 therms to 10,000 therms. In spite of Mr. Rea's COSS allegedly identifying these costs as "customer-related," the Company proposes to recover a most of these costs only from larger Rate 70 users through volumetric charges.

The Commission should reject Mr. Rea's arguments as groundless, and apply rate design principles consistently to all rate classes.

Q. Mr. Rea states on page 7 of his rebuttal testimony that "it is appropriate that the services associated with the customer charge for gas distribution should be priced to customers at or near full cost." He supports his argument by citing the Commission's recent decisions in various Delivery Service Tariff (DST) cases (p. 6-7). Do you agree that the Commission's DST decisions direct rate design in this docket?

A. I believe the logic of the Commission's DST decisions is worthy of consideration in this case, but if applied, should be applied in an even-handed manner. The Commission is acting, in the DST decisions, on the principle that competition will put downward pressure on costs. The Commission so acted because to exempt one service (metering service) from overhead cost sharing within a competitive market would place competitors at a distinct and unfair disadvantage. The Commission's goal of fostering competitive markets would be ill-served by removing overhead costs from metering service. Mr. Rea argues that the Commission's "pricing

logic and rationale" should be used in this case to set the Rate 60 customer charge.

If the Company takes the position, however, that the Commission's "pricing logic and rationale are the same" (Rea Rebuttal p. 7) in setting competitive rates and in traditional rate design, it should at least apply this logic on an even-handed basis. As noted above, the MEC proposed Rate 70 rate design discards this logic. I believe MEC, recognizing the mitigating circumstances of varied levels of consumption and cost causation, has correctly discarded the DST case "pricing logic and rationale" in setting the Rate 70 rate design and should also do so for Rate 60.

Q. Mr. Schaeffer, on page 5 of his rebuttal testimony, recommends against adopting your rate design proposal to hold the Rate 60 customer charge at the current level of $9, because "it would not show movement toward the cost of service levels endorsed by either Staff or MidAmerican in this proceeding." Do you agree that not showing movement toward the Staff or MEC COSS results ~~calculated -~~ is a reason to reject your recommendation?

A. No. Mr. Schaeffer's rationale fails on two counts. First, as I discussed at some length in my direct testimony, Rate 60 customers saw an increase of 50% in their customer charge just 18 months ago, to a rate that fully recovers all customer-related costs and then some overhead costs. Additional increases merely for the sake of movement are unnecessary. Second, the COSS is not definitive, or even necessarily directive, in rate design, as Mr. Schaeffer discusses as some length in regard to Rate 70 rate design. Rather than use the COSS results of ~~$39.86~~41.08 to set the customer charge, Mr. Schaeffer considers the varying effects of using the COSS results and instead recommends a $15 customer charge. (Rebuttal at 7)

Q. What reasons does Mr. Schaeffer offer for not following the results of the COSS with regard to his proposed Rate 70 customer charge?

A. Mr. Schaeffer notes several mitigating reasons for setting the customer charge at his proposed $15 instead of the $~~39~~41 presented in the Company's COSS, including the following:

- The large range in the size of Rate 70 customers (Schaeffer rebuttal, p. 6);
- Mitigating the impact of the customer charge to smaller Rate 70 customers (P. 7);
- Limiting the number of customer bills that face double-digit increases (p. 7).

Q. Do you agree with his use of mitigating factors to reject adherence to the COSS results?

A. Yes. These are some of the same arguments I used as a basis for my recommendation to limit the use of the Rate 60 customer charge to recover non-customer overhead costs.

Q. One of Mr. Schaeffer's mitigating factors was that Staff's proposed Rate 70 rate design would result in "double-digit increases . . .for roughly 75% of all Rate 70 sales service bills" (p. 7). Does MEC's or Staff's proposed Rate 60 rate design result in double-digit increases?

A. Yes. Applying Mr. Schaeffer's analysis for Rate 60, MEC's proposal results in double-digit increases for customer bills with usage up to approximately 50 therms per month, accounting for approximately 53% of all Rate 60 bills. The lowest use customers would see bill increases as high as 33%, while the very highest use customers would experience bill decreases. Staff's proposal is less extreme, but still results in a wide differential burden within the rate class; 10% of customer bills experience double-digit bill increases, with a range of increase from 0% to 14%. With both Staff's and MEC's proposal, the customers that get the most benefit from

the system (the largest users) see the lowest rate increases.

Q. Does your rate design proposal mitigate this exposure to large bill increases?

A. Yes. My Rate 60 rate design proposal results in no Rate 60 customer experiencing a double-digit increase. The greatest increase for any monthly bill would be 8.9%. Similarly, no customer would see a rate decrease – the lowest increase would be 0%. My recommendation is far more equitable for Rate 60 customers as a class than either the MEC or Staff proposal. In my proposal, furthermore, the customers that get the largest benefit from the system also see the largest rate increases, and the customers getting the fewest benefits and causing the fewest costs experience the smallest rate increases.

Q. On page 17 of his rebuttal testimony, Mr. Rea states that your arguments' "chief purpose appears to be to confuse the cost causation issues to the point that costs can only be allocated and charged on a volumetric basis by default" (p. 17). Did you recommend that the costs discussed in your direct testimony be allocated only on a volumetric basis?

A. No. I am baffled as to Mr. Rea's characterization. Mr. Rea did refine his characterization somewhat in response to CUB data request 2.10, in which he noted that the word "costs" in the above statement referred to those costs with uncertain or questionable causation. Regardless, the customer charge that I recommend in fact recovers some of these costs with "uncertain or questionable causation." My recommended Rate 60 customer charge would recover approximately half of the MEC margin, with approximately half recovered in the volumetric charge.

Q. Does Mr. Rea believe that recovering half of the MEC margin through the customer charge is reasonable?

A. Mr. Rea does not believe that recovering half of the MEC margin through the customer charge is reasonable. In response to CUB Data Request 2.10, concerning my adjustment, for rate design purposes, to the MEC COSS customer-cost estimate, Mr. Rea criticized my recommendation by stating the following:

> Mr. Ross' testimony attempts to legitimize a Rate 60 customer charge of $8.53 which is 33% lower than the one justified by MEC's original cost of service of $~~12.89~~.

Given, however, that MEC's recommended Rate 70 customer charge ($15) is 63~~2~~% lower "than the one justified by MEC's original cost of service" of $41~~39~~, Mr. Rea's criticism is somewhat hollow.

Q. Mr. Rea, on pages 10 and 11 of his rebuttal testimony, describes why he believes your comparison of MEC's proposed Rate 60 customer charge to other utilities is misrepresentative. What is his criticism, and your response?

A. Mr. Rea states that a comparison of MEC's customer charges to other utilities is unfair because I did not consider the first block that other utilities have, in which they recover similar costs that MEC proposes to recover in the customer charge. I did not include that comparison because first block charges are volumetric charges. The use of a volumetric blocked charge does allow more flexibility in setting a lower customer charge, and can, depending on how large the first block is, mitigate some of the differences in cost causation and relative benefit received between non-heating/low use customers and the larger heating customers within the same rate class. MEC does not propose a blocked rate, and has chosen not to mitigate the bill impacts of back-to-back large increases in the customer charge. The MEC proposed customer charge is not justified.

Q. Does your rate design proposal unduly burden heating customers, as Mr. Rea describes on pages 14 and 15 of his rebuttal testimony?

A. No more than is necessitated by MEC proposed revenue increase. As noted above, no residential heating bill will increase by more than 8.9% under my proposal. I would prefer, as is likely the case for Mr. Rea, that customers not face any increase. Furthermore, the largest increases in my proposal are borne by those customers that have the most opportunity to reduce bill impacts through their own actions (investing in energy efficiency, using set-back thermostats, and conservation choices).

Q. On page 14 of his direct testimony, Staff witness Mr. Luth defines the types of charges that are used to recover costs. He distinguishes customer charges, distribution energy charges, and distribution demand charges as the three primary categories charges to consider in rate design. Do you agree with his descriptions?

A. I agree with his general categories, and with his description of distribution energy charges and distribution demand charges. I disagree, however with his description of customer charges. Mr. Luth states that a "customer charge recovers customer-related costs that theoretically do not vary with energy or demand." As such I believe he is defining customer-related costs by what they do not do – vary with energy or demand. Under such a definition, customer-related costs could easily include costs that are not customer-related, but also do not vary with energy or demand. Common costs should not be categorized as customer-related, and the customer charge is not the default means of recovering such costs.

Q. Do you agree with Mr. Luth's Rate 60 rate design proposal?

A. I do not agree with Mr. Luth's proposal. He proposes to hold the energy charge at its

current level, and increase the customer charge to $10.30. His rationale is based on the results of his COSS calculations, modified to "maintain a continuity of charges in Rate 60" (p. 14). I believe that he is over-reliant on the results of his COSS, without attending to the limitations of COSS analysis in guiding rate design. As I described in my direct testimony, the COSS shows customer-related accounts only after they have been loaded with non-customer-related costs. Additional mitigating circumstances, including the 50% increase in customer charge experienced by Rate 60 customers only 18 months ago, and the diversity in cost causation within the Rate 60 class, call for holding the customer charge steady, and focusing on the energy charge to recover new cost increases.

Cost of Service Study Issues

Q. On page 9 of his direct testimony, Mr. Rea disagrees with your recommended allocator for the costs associated with distribution system mains. He states that your proposal "is incomplete, and (is) based on logic that is incomplete." What evidence or argument does Mr. Rea present to support his assertion?

A. Mr. Rea starts by agreeing with the facts of my argument, that capacity costs associated with pipelines are by definition declining marginal costs (every increment of capacity is less costly that the one before it), and that an allocation based solely on load factor fails to capture this cost distinction (Rea rebuttal, page 7). He does not dispute my use of average throughput as a statistic that separates throughput from capacity (which he also used in his allocation). His argument focuses on my point that if the costs of meeting gas usage over and above average throughput are declining on a marginal basis, then any cost allocation between throughput and capacity must recognize that capacity-related gas usage (usage greater than the average) is less

196 costly per unit than average-throughput-related gas usage.

197 Mr. Rea disputes my argument only by asserting that I "essentially (propose) a minimum
198 system approach . . ." (p. 10). Mr. Rea is mistaken – I do not recommend a minimum system
199 approach. The minimum-system approach has been correctly rejected by this Commission and, I
200 believe, is clearly contrary to reasonable economic theory and inconsistent with the nature of
201 energy markets.

202 Mr. Rea offers no evidence that my recommendation is faulty or inappropriate, or that his
203 recommendation is superior.

204 **Q. Do you recommend, as Mr. Rea asserts that you do, a modified minimum-system**
205 **approach?**

206 A. No. The basis for the minimum-system approach is the assumption that some portion of
207 the gas distribution-system (upstream of the service line) is customer-related; that a theoretical
208 "minimum-system" of gas mains is required by all customers, and should be paid for by each
209 customer. I reject the minimum-system approach to cost allocation, Mr. Rea rejects the
210 minimum-system approach, and no other witnesses advocate a minimum-system approach.
211 Given that no witness is advocating a minimum-system approach, the Commission should
212 disregard Mr. Rea's discussion of minimum-system allocation.

213 **Q. Other than his attempt to associate your allocation method with a minimum-system**
214 **allocation method, what is Mr. Rea's primary objection to your recommendation?**

215 A. I have been unable to identify an objection, either from Mr. Rea's testimony or his
216 responses to data requests, that does not equally apply to his own recommendations. For
217 example, in CUB Data Request 2.07 I asked Mr. Rea to explain his statement on page 8 of his

rebuttal testimony, that my treatment of "static" costs of distribution mains (costs that do not vary with the capacity of the pipe) was "simply unreasonable." He stated the following

> Mr. Ross' treatment of "static" costs is not reasonable because he specifically identifies this subset of costs as not being related to pipe size but allocates them as if they were. Mr. Ross specially identifies a subset of mains costs that are not related to mains capacity. This clearly implies that these costs are not related either to throughput capacity or peaking capacity. However, when considering the allocation of these "static" costs identified as not related to throughput or peaking capacity, he assumes that they, in fact, are related to throughput and peaking capacity because this is the basis upon which they are allocated. This is not reasonable.

Yet Mr. Rea also defines and discusses "static" costs (rebuttal p. 8), agrees that these costs do not vary with capacity (rebuttal p. 7), and agrees that his allocation method assigned these costs to capacity and throughput function (response to CUB data request 2.06). Furthermore, in his COSS Mr. Rea allocates many costs that do not vary with number of customers, throughput, or peak demand to the customer, throughput, and demand functions (Direct testimony, lines 127-169, Response to CUB data request 2.01).

My recommended allocation method is entirely reasonable, as is Mr. Rea's allocation method. My recommended allocation has the identical theoretical basis as Mr. Rea's method. We both agree that the costs associated with distribution mains should be allocated between throughput and peaking functions. We both agree that average throughput and peak-day use are reasonable statistics for developing an allocator. The only difference between Mr. Rea's method and mine is that mine recognizes that capacity costs associated with distribution mains are declining costs per unit of capacity, while Mr. Rea's method does not.

The Commission should reject Mr. Rea's rebuttal arguments as inconsistent and unsupported, and should use an allocation method for costs associated with gas distribution

mains that acknowledges the facts of this case.

Q. Are there any other concerns you have regarding Mr. Rea's rebuttal testimony?

Mr. Rea, in his rebuttal testimony and in responses to data requests, made a number of unsupported and erroneous characterizations of my direct testimony, offering testimony in regard to my motives rather than explaining why he believes his recommendations more appropriate than mine. Mr. Rea stated, among other assertions, that my testimony was designed to "confuse" (p. 17), to "muddy" (p. 16), to "manipulate" (p. 5), and to "arrive at a predetermined outcome" (p. 5). In CUB 2.10 I asked Mr. Rea to provide evidence for his assertions about my motives. Part of his response included the following:

> . . . it is logical to conclude that a reasonable strategy to legitimize a relatively small customer charge would be to create confusion on cost causation issues for as many categories of cost as possible. As Mr. Ross has made contradictory claims of cost causation of the distribution system, it would be reasonable to suspect that he may be pursuing such a strategy.

I believe my direct testimony and recommendations are quite clear, and based on reasonable and accepted concepts of cost allocation and rate design, concepts and principles I made explicit in my direct testimony. I did not have a hidden agenda or secret strategy – I presented evidence and specific recommendations that can be evaluated on their own merit. The Commission should disregard Mr. Rea's allegations of secret strategies to create confusion.

Uncollectible Accounts Expense

Q. You proposed, in your direct testimony, an adjustment to MEC's recommended uncollectible expense. Mr. Tunning, on page 4 of his rebuttal testimony, disagrees with your adjustment. What are his concerns?

A. Mr. Tunning believes that my method, which used an average of 1998 and 1999 uncollectible accounts, does not incorporate factors such as the impact of the rate increase

allowed in 99-0534 and the effect of recent general economic conditions. I noted in my direct testimony that my recommendation allowed for an increase over what was approved in docket 99-0534. Given the very short period of time between the recent rate change and the test year, my recommended increase should be sufficient to account for changes in economic conditions and effects of the previous rate increase. However, I have no objection to increasing my uncollectible expense recommendation should Mr. Tunning provide evidence that economic conditions or the previous rate increase had a greater impact on uncollectible accounts than I have allowed.

I believe, however, as noted by Mr. Tunning in his direct testimony (p. 6), that the large increase in 2000 and 2001 uncollectible expense is probably attributable to the extraordinarily high gas costs that winter. The high gas costs were not part of either general economic conditions, nor the rate increase approved in docket 99-0534. I continue to recommend that the 2001 level of uncollectible expense should not be used as the basis for setting rates in this docket.

Q. Does this conclude your rebuttal testimony?

A. Yes.